May 20, 2015

Mr. Martín Magaña
City Manager
City of Desert Hot Springs
65-950 Pierson Blvd.
Desert Hot Springs, CA 92240

Dear Mr. Magaña:

Urban Futures, Inc. (UFI) is pleased to provide this Financial Report and Desert Hot Springs Recovery Action Plan (DHSRAP) to the City of Desert Hot Springs (City). This report contain two primary parts: 1) an estimated month-by-month cash-flow analysis for the remainder of Fiscal Year (FY) 2014-15, projected cash flows for FYs 2015-16 and 2016-17, and annual cash flows for FY 2017-18 and FY 2018-19 (the Financial Report); and 2) UFI's analysis and recommendations in association with a recovery action plan (DHSRAP).

The purpose of the cash-flow analysis is to identify and project the City's cash position as of June 30, 2015. The DHSRAP presents recommendations based on our analysis of the organization in an effort to reduce costs, increase revenues, revise current budget processes and provide an action plan for staff and the City Council to improve fiscal and operational performance.

Desert Hot Springs continues to be affected by the serious economic recession, and while staff and the City Council have taken positive steps to produce a balanced budget, more is needed. Expenses continue to rise while revenues remain relatively flat. Very low general fund balances and lower-than-norm non-General Fund balances exacerbate this problem. The five-year forecast reflects a similar outlook holding similar economic and budgetary assumptions; in other words, the City could face a precarious balancing act in the City's FY 2015-16 and FY 2016-17 budgets. As indicated in our February 12, 2012 report, the City must continue to take action to reduce its spending and increase its revenues in order to emerge from a relatively flat scenario and move to a much more positive one.

Based on UFI's extensive experience with the City's financials and our understanding of its budget practices, the following is a summary of our high-level recommendations:

- Implement a **prioritized budget process**;
- Explore and implement certain **cost-sharing initiatives** to conserve dollars;

- Study and consider the **adoption of a biannual (two fiscal years) budget document** for longer-range planning purposes (or at least until the fiscal crises has passed);
- Temporarily **decrease or suspend expenses that do not provide direct city services** to the residents of Desert Hot Springs; and
- Using the prioritized budget process, **engage key stakeholders, residents and businesses in strategic planning discussions** regarding the City's service level and financial resource needs.

The DHSRAP included in this report identifies solutions for addressing some of the more immediate issues that face the City. We appreciate the timely assistance of staff in providing the data necessary for drafting the attached report. We look forward to continuing our assistance as the City implements tough decisions to balance its financial resources.

Respectfully Submitted,

Michael Busch, President & CEO
URBAN FUTURES, INC.

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Executive Summary & Background

The City retained Urban Futures Inc. to assist the City with reviewing and analyzing conditions and mechanisms which affect the current and future financial performance of the City. This study is a follow-up to a similar study presented to the City on February 12, 2012 and a three-year cash flow analysis presented to City Council on May 5, 2015. The 2012 study made recommendations based on several phases including: document review; meetings with staff; a financial strengths, weaknesses, opportunities, and threats analysis (SWOT); and development of a financial sustainability plan.

Each of the options/recommendations as presented in the 2012 report represented difficult choices, and they required the support of the organization, Council and Community. Even with the partial remediation effort, City revenues have remained relatively flat. This, in the face of expenses that have continued to keep pace with natural inflation and/or have increased outside of the City's control, creating a structural budget deficit. To fund the City's deficit budgets after the failure to two (2) proposed revenue measures denied by the voters, extensive drawdown of reserves was used to balance operating expenses, and one-time sources of monies were used to fund ongoing operational costs.

As outlined in the Three-Year Cash Flow Analysis presented at the May 5, 2015 City Council meeting, recent cost cutting actions have financially stabilized the City for this fiscal year (FY 2014-15) resulting in a positive cash flow and general fund operating balance. However, the subsequent years show continued decreases in cash flows ending in a worsening financial position and possible insolvency in FY 2019-20 or FY 2020-21.

< Executive Summary >

To assist the City in navigating out of such an outcome, UFI has developed the Desert Hot Springs Recovery Action Plan (DHSRAP), which includes suggestions to help stabilize the City's financial situation to a balanced level, build reserves, and provide future direction to the City Council and City staff. **It should be noted that most of the suggestions/considerations/recommendations in this report are not easy. They will require policy creation, spending discipline, renewed and aggressive cost-sharing negotiations, and tough prioritizations that will result in the decrease of support to certain programs and the elimination (for the short time) of others. All will require a collective show of political will amongst all stakeholders from City staff and City Council to the public.** We believe that the recommendations in this report will further stabilize the City's economic outlook and increase the level of basic city services, which aligns with the Council's goals and policy objectives and meets what the City residents deserve.

Our suggestions and recommendations include:

- Implementing a Priority Budget Process System and a Participatory Budget Process
- Moratorium or Phasing Down of Certain Funding of Non-Direct City Services
- Recommendation of a Biennial Budget Model for FY 2016-18 to Stabilize Expenses and Provide the Council and Staff with Better Long Term Planning
- Continuation of Addressing Service Delivery Model Changes
- Aggressively Seeking and Implementing Cost Sharing Opportunities
- Continue Reviewing Revenue Increase Opportunities
- Establish Minimum General Reserve Levels
- Review and Amending of Current Long Term Leases and Debt Obligations
- Revision and Adoption of a New Comprehensive Five-Year Economic Development Strategic Plan that Emphasis Job Creation and Long Term Growth
- Consistent Updating and Use of UFI's Five-Year Financial Plan to Help Guide the City on Financial Decisions and Continue Replacing Forecasted Numbers with Actuals
- Find Measures to Lift City Staff Moral through Slow Restoration of Salary Levels and Providing "Unique" Benefits that Would Help the City Retain their Best Employees and Recruit Others.
- Pursue new revenue sources i.e. tax measures

It is without question that timely implementation of the plan is necessary given the current and anticipated cash-flow constraints in fiscal year 2015-16 and 2016-17. The next step for the City will be to meet and schedule study sessions regarding the DHSRAP and for staff to research and bring forward specific recommendations that affect these areas.

< Recommendations from 2012 Report >

Over the past several years, the City has balanced its budget through a combination of cost reductions including layoffs, unfilled vacancies, and a reduction of public safety expenses, transfers from other funds, cutting of certain expenses, and use of unallocated fund balance. The City has gone through personnel reductions, which resulted in the reduction of workforce of approximately ten positions (14.3 percent) over the last three years. All departments have had to make changes to reduce costs.

This was the same situation the City faced in FY 2011-2012. The City contracted with UFI, to help with their budget issues and make recommendations to help alleviate their financial issues. The February 12, 2012 report to the City outlined 17 recommendations, as listed below. Please refer to the Appendix for a more detailed discussion of those recommendations, the results of those recommendations three years later, and a current update of the Strengths/Weaknesses/Opportunities/Threats (SWOT) analysis:

1) Adopt a budget philosophy to provide a meaningful and easy to understand framework for maintaining financial discipline. Present a report to the City Council on the financial results of the policies at least once a year. Present an updated five-year forecast to the City Council at least three times a year.
2) Initiate significant immediate changes to the expenditure and revenue base, with major reductions in spending taking effect in FY 2011/12 increasing into FY 2012/13.
3) Conduct an analysis of each internal service fund to determine funding requirements for the services and equipment paid for out of each of those funds and create a five-year forecast for each ISF. Set rates to departments based on a cost allocation study and funding requirements for each ISF. Shift any excess balances into unrestricted fund balance to build the General Fund reserve.
4) Determine the City Council's interest in asking the voters to approve new or increased taxes. Once that is ascertained, develop an action plan and schedule to seek voter approval of new revenues.
5) Engage a private firm to perform an audit of the property tax assessments to ensure data is current and up to date.
6) Evaluate all franchise agreements for cost cutting and/or revenue generating opportunities.
7) Analyze the amount of additional revenue that would be received by the City if a change in the utility franchise fee allocation were implemented. Advocate for a change in legislation to correct the law.
8) Implement a paramedic subscription program to recover costs associated with Contract Fire Service. Anticipated Revenue Increase: $240,000.
9) Develop a marketing program for paramedic subscriptions with a goal of market penetration to at least 50% of households. Develop marketing efforts to target those most likely to subscribe and plan a campaign that will be ongoing.
10) Determine the fee level required to recover all City costs associated with false alarm response and increase fees accordingly. Anticipated Revenue Increase: TBD.
11) Develop a comprehensive asset management program, identify market rental rates and subsidies, and sell unneeded and under-performing properties. Conduct an analysis of all property assets as part of the asset management program. Anticipated Revenue: TBD.
12) Implement a 10 to 15 step range to spread out merit (performance) increases over six to nine years rather than the current three and a half to four.
13) Initiate discussions with Cal Fire and other cities in the area about a regionalized approach through the establishments of a Fire District. If successful, this could create economies of scale by eliminating redundant programs and costs.
14) Contract with the City of Palm Springs or Indio for all animal control services. Develop a detailed implementation plan.
15) Utilize retired police officers as trainers and reallocate full-time sworn personnel from this operation.
16) Merge the Planning, Building and Engineering with Community Development.

17) Create an internal and external communications and engagement plan. Temporarily reassign positions within the City to provide analytical support for implementing a budget stabilization plan and a communications plan.

< Background on City and General Financial Outlook >

The City of Desert Hot Springs (DHS or City) is located in Riverside County in Southern California. As of the 2010 census, it had a population of approximately 26,000 residents. Population has increased rapidly since the 1970's. The City is mainly a bedroom community. Its largest employers are local government agencies, hotels and a non-profit agency operating residential housing for developmentally disabled youth. The business base is geared to the support of these employers. There is no "big box" or auto retail operation such as Home Depot, Costco or a flagship auto dealership. February 2015 data indicates that the unemployment rate in the City and Riverside County overall is 8.2 percent and 6.9 percent, respectively. Within the Coachella Valley, the City has the second highest unemployment rate behind the City of Coachella at 10.7 percent.

A confluence of economic events and issues specific to the City hamper the City's full financial recovery. In 2001, the city suffered the loss of a Fair Housing Act lawsuit resulting in a judgment of some $3 million. Subsequently, the City filed for bankruptcy protection, and in 2004 emerged, after issuing judgment bonds. Those bonds are still being paid off, which significantly affected the City's economic vitality.

Public safety is a high priority in the City. Prior to 1997, police services were provided by the Riverside County Sheriff's Department. In 1997, the City instituted its own Police Department. City leaders have addressed the crime rate by increasing the number of sworn officers, supported, in part, by two ballot measures, one creating a parcel tax and another creating a 2 percent surcharge on the Utility Users Tax to support public safety. While the initial efforts appear to have been successful, as the crime rate in the City had dropped; crime rates seem to be on the rise again with the general fund contributing more revenues than the recently passed tax. The Public Safety Department's budget comprises approximately 60 percent of the consolidated general fund budget, leaving the City Council with fewer choices to make.

The City also continues to experience declines in general fund cash balances, anticipating further declines in FY 2015-16 and 2016-17. In FY 2016-17, the consolidated general fund ending cash balances will decline by 50 percent compared to FY 2014-15. In addition to cash-flow constraints identified in the five-year financial forecast, the City's two voter-approved tax measures expire in FY 2019-20 and FY 2020-21, which could leave the City in an even more challenging situation than the current one.

Over the past two fiscal years, the City has reduced positions, outsourced services, negotiated and imposed significant compensation reductions, and increased fees to maintain both essential City services and a sufficient general fund working capital balance. While the City has used various fund balances to close the gap between annual expenditures and revenues, this practice has left the City with limited cash reserves to put away for natural or fiscal emergencies and for cash flow purposes.

Several options remain to reduce costs; but they are difficult options the City Council must carefully balance as the Council navigates the City of the current situation. These considerations include: outsourcing a number of current services; reducing non-direct City service allocation options; implementing specific cost-sharing initiatives; and approving revenue measures requiring voter approval.

With several multi-year labor agreements approaching their renewal period, cost reduction options are even more challenging, given the approximately 25 percent reduction in salaries that current staff have already absorbed over the last several years.

The financial and operational instability leading to the cost reductions mentioned above, while helping cut the deficits in the budget, could lead to longer-term personnel issues including employee retention and employee recruitment issues, especially as the City recruits for high-quality employees. Current compensation levels for staff are well below the averages in the Coachella Valley, contributing to the City's difficulty with realizing staff stabilization.

There are a few opportunities to increase revenue to the funding levels needed to resolve the budget deficit and to adequately fund essential services. Such opportunities require voter-approved tax increases or significant economic development activities. While such increases are possible, the options are constrained by current economic conditions including higher unemployment, low household incomes and the fact that the voters recently passed a special tax for Police services in 2010 and did not pass another tax increase in the last two years. The lack of a supportive pro-vote organization and a good public information campaign may have also affected the results of that vote.

General Financial and Budget Considerations

The following are general financial and budget best practices and other considerations to support the discussion leading toward more specific recommendations as detailed in the subsequent section:

< Financial Considerations >

1. **Development of a Budget and Financial Philosophy**
   An important strategy for the City is a budget philosophy and practice that's relatively easy to understand and can serve as a meaningful framework for maintaining financial discipline. Obtaining and understanding the City Council's goals and objectives, prioritizing needs and expenses, maintaining an environment friendly to economic development, and keeping the economic conversations open between the City Council and the community are important philosophies. Continued regular reporting of financial performance to the governing body for public discussion is also a way for the fiduciary responsibilities of the elected officials and executive managers to be understood by the public and other organizations.

2. **Structurally Balanced Budget**
   The annual budgets for all of a city's funds should be structurally balanced throughout the budget process. Ongoing revenue should be equal to or exceed operating expenditures in both the proposed and adopted budgets. If a structural imbalance occurs, a plan should be developed and implemented to bring the budget back into structural balance. Use of fund balances to balance operational expenses should be avoided or be kept at a minimum.

3. **Multi-Year Financial Forecasting**
   A biannual budget supported by a five-year financial forecast developed by staff and utilized by a city's council promotes awareness of how current budget decisions impact future financial health. Using some method of budget prioritization, a general fund proposed budget balancing plan can be presented and discussed in context of the five-year forecast. Any revisions to the proposed budget should include an analysis of the impact on the forecast out years as well as on the current budget. If a revision creates a negative impact on the forecast, a funding plan should be developed and approved to offset the impact. The five-year forecast should be updated quarterly to reflect changes in revenues and unexpected changes in expenditures along with the budget. The forecast should be presented to the governing body quarterly for discussion and to provide information to the public.

4. Use of One-Time Resources

Use of one-time resources (e.g., revenue spikes, budget savings, sale of surplus equipment and/or property, and similar nonrecurring revenue) is discouraged for application to current or new ongoing operating expenses. Examples of appropriate uses of one-time resources include rebuilding reserves, retiring debt early, making capital expenditures (without significant operating and maintenance costs), and other nonrecurring expenditures.

5. Established Reserves

Most cities maintain multiple funds based on different revenue sources and requirements. Because there are risks (both known and unknown), it is important that reserve levels in all funds be maintained as a hedge against such risks. Without proper reserves, there can be major disruptions in services when unforeseen financial demands emerge, requiring immediate attention. Thus, agencies should maintain an adequate reserve level and/or ending fund balance for each fund – not just the general fund – as determined annually and as appropriate for each. For the general fund, different types of reserves should be maintained, including an economic uncertainty reserve (sometimes called a contingency) to provide a cushion for unexpectedly low revenues in any given year and for other emergency needs that arise.

6. Employee Retention and Recruitment

In an environment of reductions in employee compensation, negotiations for employee compensation should continue to consider total compensation bargaining concepts and focus on all personnel services cost changes (e.g., step increases and the cost of benefit increases). As a general goal, the cities should seek to provide a competitive wage and benefit package with anticipated compensation costs included in the above-mentioned five-year financial forecast to ascertain affordability to the municipality relative to expected revenues. With the City's current employees receiving an average reduction in salary of approximately 20-25 percent, the City has exposed itself to the dangers of losing staff and having major hurdles in recruiting new and experienced staff for future positions. City services are only as good as the staff providing them, and graduated plan to slowly return employees to competitive salary and benefit levels is an important consideration.

7. Fees and Charges

As mentioned in our earlier report, fee increases should be utilized where possible to assure program operating costs are fully covered by fee revenue. It is a best practice to explore opportunities to establish new fees for services where appropriate or make adjustments based on the appropriate inflationary index, as necessary. All cost recovery fees should be reviewed annually at the time of preparing the operation budget, and a comprehensive fee study, including Development Impact Fees (DIF), should be conducted approximately every three years, with finance staff preparing the annual fee calculations.

8. Capital Improvement Projects & Equipment Replacement

For an agency the size of the City, capital improvement projects and the replacement of equipment with annual operating and maintenance costs exceeding $25,000 should not proceed without council certification that funding is available in the applicable funding year of the project. Also, a five-year capital improvement plan (CIP) should be developed, implemented and funded in order to ensure that the backlog of capital maintenance and equipment replacement needs do not grow beyond current levels.

9. Grants

City staff currently seeks, applies for, and effectively administers federal, state and other grants that address the City's priorities and policy objectives and provide a positive benefit. This is consistent with best practices. Before any grant is pursued, staff should provide a detailed pro-forma that addresses the following: 1) availability of the required match or cash on hand if the grant revenue is received as a reimbursable; and 2) immediate and long-term costs and benefits of accepting the grant requirements. One-time operating grant revenues should not be used to begin or support the costs of ongoing programs. Another best practice that has emerged from the current economic climate is exploring partnerships with other locality-based agencies when applying for grants and dedicating staff efforts to meet granting agency personnel and legislatures in the area that can help with decision-making and ease the administrative burden associated with applying for grants.

Besides the need for development and implementation of best practices in terms of financial policies and procedures, cities such as Desert Hot Springs, specifically, may wish to consider the following:

- Evaluate and aggressively pursue joint services and public/private partnerships (also mentioned above);
- Implement full cost recovery for fees such as building, planning, etc.;
- Quarterly review of the City's financial performance by the City Council;
- Implement an audit process for facilities approved within the City (e.g. marijuana facility) to ensure tax revenues are accurately reported and sent to the City;
- Sale of all City/Successor Agency-owned parcels in order to generate additional property taxes as well as economic development once the transfer occurs;

- Continued audits of property assessments and tax bills for possible generation of additional revenue that was lost due across the broad reductions during the downturn in the economy; and
- Developing a plan for enhancement of voter-approved revenues and the replacement of expiring voter-approved revenues at the end of this decade.

< General Budget Issues >

A public agency's inability to provide essential services is a strong indication of a fiscal emergency. As noted by the Governmental Accounting Standards Board (GASB), the common themes that have been either formalized or are working definitions of financial sustainability include the ability to continue public services and/or existing programs. This comports with the definition of "financial condition" adopted by the International City/County Management Association (ICMA). In particular, ICMA defines a municipality's financial condition as the ability to (1) maintain existing service levels, (2) withstand local and regional economic disruptions, and (3) meet the demands of natural growth, decline, and change. ICMA also categorizes financial solvency in four distinct ways:

1. **Cash solvency:** government's ability to generate enough cash over a 30 to 60-day period to meet its obligations;
2. **Budgetary solvency:** government's ability to generate enough revenues over its normal budgetary process to meet its expenditures and not incur deficits;
3. **Long-run solvency:** government's ability to meet expenditures that may not be addressed as part of the normal recurring annual budgetary process; and
4. **Service-level solvency:** government's ability to provide services at the level and quality that are required for the health, safety, and welfare of the community and to meet its citizens' desires.

No one argues the City of Desert Hot Springs is going through a sustained negative economic period with relatively flat revenues and increasing expenses. It is also acknowledged that the City has been cutting expenses in order to balance this fiscal year's budget.

Moving forward, the City must contend with two main issues: 1) it must budget in an effort to meet its legal obligations, build reserves, and ensure that budgetary shortfalls are addressed through balancing actions; and 2) the City's expense cutting has decreased service delivery to residents to a point where base services are being significantly affected and needs to be restored.

However, the City has reached the point in the current fiscal year budget where revenues are still not meeting expenses and additional cuts were necessary to balance budget resources. These cuts, combined with past reductions in personnel and services, has significantly affected the City's ability to deliver high quality services to the residents. The threat posed by continued service reductions is imminent, and despite all other measures taken to this point and those still to be implemented, no viable alternative plan that is sufficient to address this problem has been identified that does not require revenue measures requiring a vote of the people. As such, UFI believes that the City continues to faces a service-level emergency, a form of fiscal emergency which requires a number of steps to stabilize the budget and to fund essential services.

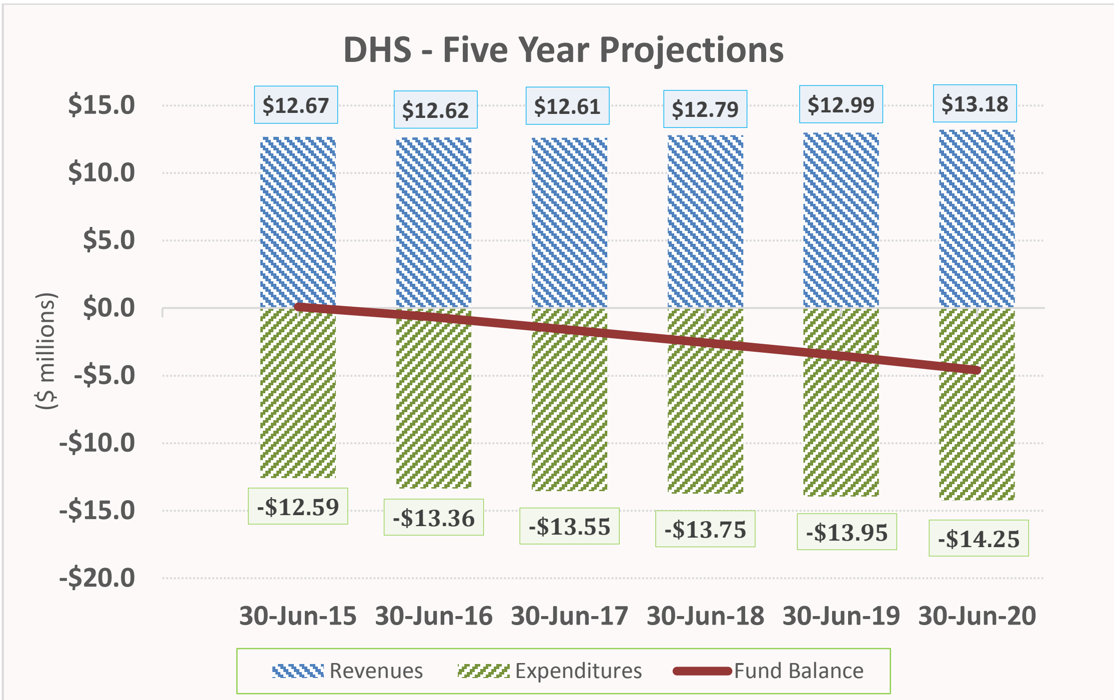
Without significant increases in ongoing revenue, a significant gap between essential services expenditures and revenues will persist over the next five years, causing further declines in cash balances and growing deficits in future financial forecasts.

The significant points to consider are:

- For the next two fiscal years, projected revenues are not sufficient to fund the current level of services, creating an ongoing structural deficit leading into the sunset of two voter-approved revenue measures that may ultimately lead to financial freefall.
- While the City has allocated revenues from various funds and other one-time revenue generation actions to balance recent budgets, the City's reserves are almost depleted leaving the City with General Fund balances of approximately **$**2.5M at the end of FY 2014-15, approximately $1.7M the following year (FY 2015-16), and approximately $850K in the third year (FY 2016-17), indicating cash decreases to the point of budget and service-level insolvency if not remedied soon.
- Because of the time necessary to implement policies and obtain new revenues, a redirection in expenditures will be required to meet the limitations of available revenue and provide the City services needed by the residents. Thus, a prioritization of program expenses needs to take place in order for staff to fund following the City Council's directions and priorities.
- As mentioned before, a concentrated effort to educate the residents before any voter-approved measures are considered and presented to the voters is needed to avoid close but unsuccessful results and to avoid recent past approval failures.

< Five-Year Financial Model >

The City understands of the best practice of multi-year financial models as described above. Based on this understanding, the City requested UFI to expand the three-year cash flow model to develop a five-year financial model that City staff plans to use on a regular basis. In this way, staff can determine the effects that certain financial actions will have on the City's future budgets and fund balances. The model is geared toward the General Fund only, and it does not include future transfers (in or out) to other funds not listed in the recommended FY 2015-16 budget. The following table shows the projected revenues, expenditures, and net loss currently and over the next five years.



The detailed operating forecast (please refer to Appendix B) is not a prediction of future policy decisions made by the City Council, nor does it represent UFI's recommendation as to what spending and revenue levels should be. It reflects a structural deficit throughout the forecast, validated by increasing operational costs which are driven primarily by the following factors: 1) public safety cost increases; 2) operational costs subject to inflationary factors and, 3) one-time savings that cannot be duplicated in future revenues or expenditure cuts.

The rate of revenue growth has been and continues to be insufficient to meet the contractual and service obligations of the City. Furthermore, as the City has previously utilized general fund reserves to meet its budget obligations, there are no additional sources with which to fill the gap. Over the past several years, relatively flat revenue growth combined with increases in public safety service expenditures and others have continued to deplete reserves resulting in a growing annual structural deficit and the possibility of cash insolvency. In the future, key contributors to the annual deficit are the increasing costs of essential services. While the City was successful in reducing essential service delivery costs, including public safety, in the FY 2013-14 Budget, going forward, these services will increase at a rate outpacing anticipated revenue growth, thereby crowding out other essential services leaving the City with two options; 1) additional service level cuts furthering service level insolvency concerns; and/or 2) the need for revenue restructuring including voter approved measures.

Action Plan Recommendations

Through our research and S.W.O.T. analysis, we have outlined many of the issues facing the City that need to be addressed for long-term economic health. The City Council, for its part, following staff recommendations was able to balance the FY 2014-15 budget and to give itself a small window of time to address these issues. The following are actions and directions that we recommend the City Council and staff review and consider for implementation to help short and long term financial health while improving the quality of life in Desert Hot Springs.

< Review Public Safety Costs >

The City places a high priority on public safety services. The percentage of the General Fund resources allocated to public safety is growing. During budget balancing cuts in recent years, the cost of public safety has been renegotiated and City may seek additional cost reductions. However, to ensure service levels do not further deteriorate the City should review the following options:

- Identify services within the police department currently performed by sworn staff that can be performed by non-sworn staff;
- Identify potential services the County Sheriff’s department can perform (i.e., homicide investigations) ;
- Seek opportunities to form joint power authority services with neighborhood cities within the Coachella Valley, or contract traffic enforcement services with an adjacent community;
- Look at revenue generating opportunity such as an impound lot; and
- Consider private fire service contracting options (Rural Metro and/or Centerra).

Another aspect of the public safety costs are number and type of calls. The City is experiencing a phenomenon many other communities face when police and fire units are called using emergency numbers and when the emergency units show up, the “emergencies” are non-existent and non-emergency services are being requested of them. This significantly increases the cost of safety services and threatens the community when it really needs emergency services. Different communities have handled this in different ways. One way is to set a limit of these types of calls, and when they occur over this limit, the homeowner or landowner is charged a fee for future non-emergency services. Another option is for “Community” units to be established, for “non-emergency” calls with non-sworn volunteer or lower cost staff answering the calls. Fees could also be charged for this service as well. There are several other options, and the City should study this situation and implement a plan to address these issues and lower the cost of these types of services.

< Maintain Full Cost Allocation Plan >

The City has hired a consultant to prepare a Cost Allocation Study and the City modified its master fee schedule accordingly. It is our recommendation to review and amend the master fee schedule every three to five years. In the meantime, City staff should prepare an annual update to the fee schedule targeting specific fee based services or programs in between the years full cost allocation studies are done, in an effort to stay abreast of certain costs and attempt to recoup its service expenses each fiscal year.

< Monitor Retirement Costs >

Because of the City's reduction in workforce and payroll, the cost for employee retirement has declined from $1.057 million in FY 2013-14 to $766,000 in FY 2014-15 and is expected to decline further in FY 2015-16. Despite recent reductions, CalPERS is under tremendous pressure to cut guaranteed interest rates and to revise their actuarial assumptions, which will more than likely increase costs for most cities, including DHS. This issue is on top of other assumption changes the CalPERS Board may add to their pension formulas and thus increasing annual costs to the City.

< Re-Evaluate Health Insurance OPEB Costs >

The City pays an average of approximately $1100 per month toward the purchase of health, dental, vision and life insurance benefits, any excess benefit money may go into the employee's 457 Deferred Compensation or they may elect to take it as taxable income.

Even though the City has tried to cut these costs, further study should be looked at to see if other more creative approaches to employee health care might yield additional cost savings without cutting medical benefits for employees. This can include switching to one health provider, joining with another agency into their plan, or negotiating special rates within the plan.

< Pursue Voter-Approved Tax and Fee Increase Measures >

Due to the City residents having a low median household income of just $30,000 annually, it is clear the passage of new tax measures and fee increases will affect residents citywide.

Given the above, and with the added economic pressure of having one parcel tax and the current UUT scheduled to sunset in the next several years (which combined generates $3.69M in annual revenue), the City must return to the voters for additional authority to levy taxes. The

City has initiated two tax measures in the past several years, both of which did not reach the minimum voter approval levels to be ratified.

There are many variables in getting tax measures approved by voters. The most important is the need for extensive polling and voter education efforts, using experienced consultants to guide the City in an effort to present a united City front before going to voters with measures on the ballot.

Without exception, the City will need to go to the voters to replace or renew the current voter approved measures expiring within the next five years unless alternative revenue measures are identified and supported by the voters. The City has several options it can take moving forward and researching voter approved revenue measures. When contemplating such measures, a number of factors need to be taken into account. These include: voter perception of the City's economic situation, voters understand of the need for the measure, and voters understanding of how funds will be allocated

California state law allows voters to approve several different types of tax measures. These include:

- Parcel Tax
- Local Sales Tax (Transactions and Use Tax)
- Utility User Tax
- Transient Occupancy Tax (Hotel Bed Tax)
- Document Transfer Tax (Real Estate)
- Community Wide Benefit Assessment
- Specific Purpose Taxes

Below, are summary descriptions of each of the tax measures the City can initiate for voter approval:

Parcel Tax – A 2/3rd voter approval is required. Tax on parcels of property is generally based on either a flat per-parcel rate or a variable rate depending on the size, use, or number of units on the parcel, imposed for any number of purposes, including funding police and fire services, and neighborhood improvement and revitalization. The City has approx. 13,878 taxable parcels as of 2010.

Local Sales Tax (Transactions and Use Tax) – For general purposes, a majority vote is needed; for special purposes 2/3rd vote is needed. The Transactions and Use Tax was adopted in 1969, authorizing the adoption of local "transactions and use tax" add-ons to the combined state and local sales tax rate. Over the years, the law was amended to allow for specific authorizations for various particular cities, counties, special districts and countywide authorities. A voter approved sale tax measure equal to a one percent surcharge on the sales tax rate would generate $1.2 million in General Fund revenue given the same rate of sales tax collection as was received in 2013.

Utility User Tax (UUT) – Over 150 cities in California currently levy a utility user tax which requires a majority vote for general purposes and 2/3rd vote for special purposes. UUT rates throughout the State range from one percent to 12.5 percent. The utilities to which the taxes are applied vary and different rates apply to residential versus commercial users. The rate in Desert Hot Springs is (7) seven percent, which is one percent above the statewide mean of six percent (in 2013).

Transient Occupancy Tax (TOT) – For general purpose initiatives a majority vote is needed; for special purpose initiatives a 2/3rd vote is needed. The City currently charges TOT on the rental of a room for less than 30 days in a hotel, motel, inn, or other lodging facility. The rate is 12 percent of the lodging rate, and this general tax currently raises approximately $1,225,000. A one percent increase would raise an additional approximately $102K annually. Because the City is already at the higher end of the statewide mean, a change in the TOT rate is not recommended as a means of increasing revenue at this time.

Document Transfer Tax (Real Estate) – For general purpose initiatives, a majority vote is needed; for special purpose initiatives 2/3rd vote is needed. Document transfer tax is a tax on the transfer of interests in real estate. It is currently imposed at a rate of $0.55 for each $500 of property value. The City receives one-half of this amount. This rate is uniform throughout the County. This tax is solely dependent on the value of real estate that changes ownership. Many cities have increased the local share of this tax. In many cases, cities have doubled the $0.55 to $1.10. Adjusting this tax to a total of $0.83 for each $500 (with the City retaining $0.55) would raise approximately $110,000 annually, based on 2015 activity.

Community-Wide Benefit Assessment – This is considered a special purposes tax and requires a 2/3rd vote for approval. Commonly referred to as a Mello-Roos, it is primarily used for capital financing of new facilities needed as a result of new development (infrastructure, parks, fire stations, etc). Some cities including the City have used this tax for operational impacts for new developments such as for public safety services (police and fire).

Specific Purpose Taxes – These are considered special purposes taxes and requires a 2/3rd vote for approval. They can be for a variety of special purposes such as libraries construction and operations, city hall construction, park acquisition and upgrades, etc. Some cities have been successful in these tax measures, tapping into voter wants and needs for special purposes, but reaching a 2/3rd vote is always difficult and takes significant voter education to achieve.

Enhanced Infrastructure Financing District (EIFD) – This is a new revision of an older facilities district law that took effect on January 1, 2015. The EIFD is a new economic development tool for local agencies to collaboratively finance critical infrastructure projects that help pave the way for greater private capital investment in the local communities. There are specific legislative purposes for a district of this type: (1) fund the creation of transit priority projects and implementation of sustainable community plans; (2) construct and rehabilitate affordable housing units; and (3) construct facilities to house providers of consumer goods and services in local communities. But unlike the previously strict requirements of redevelopment law for redevelopment plan adoptions and amendments, the City's ability to create an EIFD relies much more heavily on the City's relationship with their fellow taxing agencies, particularly Riverside County, rather than on findings of blight and CEQA compliance. We recommend that the City pursue EIFD's as an incentive for industrial and commercial development.

As mentioned earlier, the City will need to replace its expiring UUT and one parcel tax, and should study their other options at the same time before going to the voters for additional tax generation.

< Stabilize General Fund Balances and Reserves >

Reserves are crucial in stabilizing any City's finances. Reserves are not only used for unexpected natural and fiscal emergencies that may occur during the fiscal year, they are also critical in California's cyclical economy whereby significant annual revenues are received during two specific times of the year.

To ensure the City is able its month-to-month service delivery costs, the City must establish and maintain a minimum level of reserves equal to 15% of General Fund operational expenses. Because our forecast predicts the City will spend down its existing reserves, it is recommended that the City develop and implement a reserve policy, per the new Government Finance

Officers Association- best practices policies and begin to retain existing reserves while planning for increase in reserve levels as soon as financially feasible.

1. City Needs to Review and Revise Its Economic Development Strategic Plan

It has been communicated to UFI that the City is in the last year or two of its current Economic Development Strategic Plan. Because of the State's decision to dissolve redevelopment agencies, we recommend the City revise the current plan, and spend specific efforts developing a revised plan which incorporated job development and strategic use of Successor Agency held real property assets. This is one area where the City has many positive assets to assist in achieving economic development goals and objectives. With the right type of assistance, a realistic strategic plan be invaluable to the economic recovery of the City.

2. Refocus on the Delivery of Basic Services

In solving the immediate budget deficits for FY 2014-15, there has been an erosion of basic essential services to the residents. The reduction in services has occurred over the past three-four fiscal years, initially caused by the Great Recession in 2007-2010. However, while many cities have seen a recovery in the last several years, the City of Desert Hot Springs has not seen such a recovery, and instead, has had to steadily reduce expenses and City services.

On a positive note, City staff remains cautiously optimistic that planned economic development projects will come to fruition, which would positively affect sales tax revenue. However, if these projects are completed within the time-line as projected by City staff, the City would not see any significant sales tax or property tax revenues from these projects until the FY 2017-2018 budget year. This puts tremendous pressure on the City to maintain a balanced budget for the next two fiscal years, while trying to deliver services to the residents.

In an effort to provide essential services to the community, the City needs to "re-boot" its approach to funding services and to pass all expenses through a "categorization and prioritization process" to help the City Council determine funding priorities over the next several fiscal years.

It is recognized in current governmental budgeting that examining individual line item expenses do not necessarily help City's (nor City Councils) reduce or increase budgets effectively. Classifying and prioritizing service functions and then agreeing to their service levels, is a much more efficient and effective way of funding City services.

This process can be called many things, but for this report, we shall call it the DHS Priority Budget Process.

There are four phases to the DHS Priority Budget Process: 1) breaking functions/programs (i.e., expenses) down into three categories, (a) mandated/legally required, (b) basic, and (c) enhanced; 2) prioritizing the functions/programs within each of the categories (except for mandated functions/programs which all have to be funded); 3) funding the top priority functions/programs, until all the anticipated revenues have been allocated for the fiscal year. If unanticipated revenues are received during the year, the City Council can then fund the next highest priority item on the list, or if anticipated revenues are not received, then the lowest prioritized functions/programs that was funded should be suspended until additional revenue is realized; and 4) developing and implementing a budget process that includes direct resident input and participation to help staff and the City Council prioritize basic services.

Phase 1 – *Breaking functions/programs (i.e., expenses) down into three categories, (a) mandated/legally required, (b) basic, and (c) enhanced*

All functions/programs are placed within these three categories. Mandated/legally required functions / programs are legally mandated under federal, state, county law, or under that City's Charter or the State Government Code.

Examples of these include the providing of police services (through contracts with other agencies or through their own staff), certain administrative services, elections, planning services and the development and updating of the City's General Master Plan every ten years, adoption and enforcement of building codes through a mandated building official, development and maintenance of City owned public streets through a mandated city engineer, establishment of a City Council and the official recording of actions and adaptions of resolutions and ordinances at Council meetings by minutes available to the public, etc.

Basic functions/programs are those that are not legally mandated, but can only be provided by a municipality or a contracted/franchised service provider coordinated by a municipality. Examples of these include library services, provision of a city hall, establishment and maintenance of parks, trash pick-up, waste disposal, provision of water services, provision of flood control services (unless in a County Flood Control District), staff training, information technology services, staff training, certain city staff (some are mandated by law, most are not), etc.

Enhanced functions/programs are enhanced basic services or they can be standalone functions/programs. This includes examples such as four-minute response times (as opposed to six-minute response times) for police, senior citizen programs, chamber commerce funding, recreations programs, economic development services (some might call this basic), multiple planners, community centers, funding of community groups), subsidized programs, etc.

The placement of the City's functions/programs into these categories can be tricky, since some might fall into the basic category, but are really enhanced programs; they may just seem like basic services since the City has been providing them for many years, but actually are not. Certain agreements and contracts might seem to be considered a mandatory/legally required function, but are not necessarily, since all government agreements are only good for one year and require council approval through the budget process to continue for the next year.

Phase 2 – *Prioritizing the functions/programs within each of the categories (except for mandated/legally required functions/programs)*

Once all the programs/functions are categorized, a prioritization process can be initiated. This involves the City Council meeting, usually at a study session, to do the prioritization. There are a number of methods that can be used, voting using dots, numerical voting methods, averaged voting methods, weighted voting methods or just the raising of hands to each one. No one method is better than another, as long as some process is done and the result captured and reported.

In all the methods described above, there needs to be a scaled weighting factor since not every function in a category can be the number one priority. Limits would be set up, so that only 15 functions/programs can be in the first level of priorities, 10 in 2nd level, etc… Some methods require a strict ordering from #1 to #100. And since there are always limited dollars, it may turn out that only the top ten can be funded.

No matter which method is eventually used, it is with the understanding that only a finite number of programs will be funded and their prioritization illustrates the City Council's understanding of the needs of the community and their priority of the programs.

Phase 3 – *Funding of those top priority functions/programs, until anticipated revenues are all allocated out for the fiscal year*

Once the prioritization process is done, Phase 3 is more of a mathematical function until all the dollars for that fiscal year have been allocated out. If unanticipated revenue is received during the year, or expenses are less than anticipated and more money is available, the next priority program can be then funded.

Phase 4 – *Developing and implementing a formal stakeholder and resident budget participation process that brings both parties into the process and allows them to give suggestions and recommendations to the staff and City Council on budget priorities and basic services. Many communities have done this in the past with very successful results*.

The end result of this four-phase process will give staff and the City Council the information needed to prepare a balanced budget. As in any public process, there will be people who will disagree with the prioritization and possibly the categorization, but in the end this process will be efficient, fair, inclusive, transparent, and will produce a balanced budget with prioritized services being funded and lower prioritized services not being funded; until additional funds become available for allocation.

< Utilize a Biennial Budget to Achieve a Balanced Budget >

Once the mandated/legally required City services are funded and the basic (and possibly enhanced) prioritized services are funded, a biannual budget covering FY 2015-16 and FY 2016-17 budget can be adopted. As part of the DHS Priority Budget Process, the City should also consider adopting a two-year (Biennial) budget going forward. There are a number of reasons that a two-year budget, at this time, would benefit the City. These include:

- A biennial budget would lead to more effective and efficient long-term financial planning;
- This budget would also allow the departments and other programs to plan goals and objectives over two years for better long term program planning;
- Would enhance infrastructure maintenance planning allowing two year programs to go into effect;
- Could help reduce budget "incrementalism" that invariably crops up in many annual budget methods;
- Requires less time for staff and Council in the "off years" which would allow them to concentrate on specific projects, issues or programs;
- Provides enhanced guidance and more "restraint" in spending through the next two years when the budget is already set and only changes to the budget need be acted and voted on; and
- Could reduce the repetition that sometimes plague a budget process.

Should the City decide to implement a single or biannual budget process, The DHS Priority Budget Process categorization and prioritization strategy should be the basis of the budget allocations and used as the model for any future changes the City Council wants to make.

< *Limit or Stop the Use of General Fund Funding* >

As mentioned in our previous report of February 12, 2012, and subsequently in this report, the City does not have the means to realize meaningful revenue enhancements without voter-approved tax measures or significant economic development activity. Also discussed is the difficulty for management and policymakers to implement changes that are needed; they will be resisted by certain community groups, certain community members and others that are affected by certain program changes or freezes.

While the DHS Priority Budget Process is designed to balance the City budgets, other systemic changes need to be implemented for long-range stability. Nothing suggested is considered a radical approach, referring to actions other communities have taken in the face of economic declines. Fiscal discipline is the key. Other considerations in the recovery plan need to be considered and adopted to maintain a balanced budget. These include:

- **Establishing and maintaining proper reserve levels** – Establishing and maintaining proper reserve levels in the General Fund that are needed for cash flow purposes and for the City to use in case of emergencies (as mentioned earlier in this report).
- **Continuing the use of Internal Service Funds** – Internal Service Funds have been established for several uses, pursuant to accepted governmental accounting practices. An Internal Service Fund is a fund for goods and services provided for specific purposes. Rates for each Internal Service Fund are established and charged to departments for the goods and services provided to them.
- **Continue the Employer-Employee labor model, contract for service delivery or share costs with other agencies for shared City services** – The nature of the problem facing the City, as was detailed earlier to the City in our February 12, 2012 report, is that even with position reductions and elimination (there have been four different rounds of city layoff's and labor cuts) and while expenditures have been reduced, personnel costs per employee have continued to increase while revenues have remained flat. Some of these costs (Workers Compensation, PERS Retirement, Employee Medical, etc.) are out of the control of the City and are inevitable.

  The City is at a point where additional staff cuts are non-productive. Moving forward, the City will need to determine if the City wants to retain employees as an employer, or continue to contract out services. If the City decides to keep staff as employees, then the City will need to pay competitive wages and benefits to retain and recruit qualified and professional staff. Further cuts in salary or benefits would be counter-productive as well.

- **Explore regional or joint provision of public safety services** – Law enforcement departments in many areas are moving towards a regionalized approach to enhance law enforcement services and to reduce costs to individual cities. Several nearby cities contract with the County of Riverside Sheriff's Department. While this approach did not meet budget decreases acceptable to the City, another option is to talk with neighboring cities to jointly provide services, either directly or through contracting. In an effort to provide enhanced services without increasing annual budget allocations, we recommend the City's police department jointly explore service level efficiencies through shared services with the City of Palm Springs and the City of Cathedral City Police Departments.

< Contracting Out of Services and Programs >

The City has examined and achieved some savings by contracting out certain services. If the City is unable to achieve budget stability and the renewal of its current voter approved taxes, the City may have limited options including further contract service delivery options. Contracting or privatization of services is a difficult decision. Should this option reach a policy discussion level, UFI recommends a specific study be completed to verify and validate savings and service delivery assumptions prior to any formal decisions are made.

As mentioned earlier in the report, the City should review and amend its Financial/Fiscal policies as financial goals and objectives may have changed. This is a best practices for both professional government organizations- Government Finance Officers Association and International City/County Management Association– and should be a top priority for staff to accomplish in the next fiscal year. Urban Futures Inc. will provide staff a template from which to work from.

Conclusion

The City has made significant strides over the last several budget cycles in implementing its financial remediation plan. Through staff diligence and Council action, the City will end this fiscal year with positive General Fund cash balance of approximately $2.5M. However, FY 2015-16 and FY 2016-17 show continued erosion of cash balances and possible financial insolvency in the next two fiscal years if nothing is done.

Continued fiscal pressure from the persisting economic climate, however, have necessitated further cuts, and these cuts compound the difficulties with recovery efforts. The City's basic public services, for example, have been significantly impacted, and its longer-range financial picture still looks somewhat bleak.

The City has time to reverse these trends and to recover. This can only be accomplished with disciplined spending, improved economic development activities, program prioritization, creative programming, cost sharing options and implementing other recommendations as outlined in this report. We believe this can be accomplished through the adoption of the following Guiding Principles:

- **ORGANIZATIONAL INTEGRITY:** We agree to the adherence of moral and ethical principles placing emphasis on the betterment of the organization over individual results.
- **SOCIAL RESPONSIBILITY:** We agree to the principle that the organization serves to the betterment of the community and not be solely devoted to interests of the organization.
- **TRANSPARENCY:** Transparency permits the employees, elected officials, and community a greater understanding of a City's operations, including which parts of the organization are most and least efficient. This, in turn, places greater pressure on the organization to communicate openly and to produce acceptable results in all facets of a City's operations and negotiations.

UFI is committed to the City of Desert Hot Springs, and we stand ready to assist the City in any way we can to set the path toward financial sustainability and economic resiliency.

Appendix A: Summary of 2012 Report & 2015 SWOT Update

Over the past several years, the City has balanced its budget through a combination of cost reductions including layoffs, unfilled vacancies, and a reduction of public safety expenses, transfers from other funds, cutting certain expenses, and use of unallocated fund balance. The City has gone through personnel reductions, which resulted in the removal of ten positions (14.3%) over the last three years. All Departments have had to make changes to reduce costs.

This was the same situation the City faced in FY 2011-2012. The City contracted with UFI, to help with their budget issues and make recommendations to help alleviate their financial issues. In our February 12, 2012 Report to the City, we outlined 17 recommendations. Here are the recommendations and the results of those recommendations three years later:

Recommendation 1: Adopt a budget philosophy to provide a meaningful and easy to understand framework for maintaining financial discipline. Present a report to the City Council on the financial results of the policies at least once a year. Present an updated five-year forecast to the City Council at least three times a year.

RESULT: The City has implemented and continues to implement financial discipline. While the City has not updated or presented annual revisions to the original five year forecast, UFI will provide an updated five-year forecast for the City to revise each year to help with future financial planning and budgeting.

Recommendation 2: Initiate significant immediate changes to the expenditure and revenue base, with major reductions in spending taking effect in FY 2011/12 increasing into FY 2012/13.

RESULT: The City has done a number of budget cuts over the last several fiscal years in an effort to close the gap between flat revenues and increasing expenditures. The City now needs to re-balance its expenses to strengthen basic City service delivery while maintaining a positive general fund balance.

Recommendation 3: Conduct an analysis of each internal service fund to determine funding requirements for the services and equipment paid for out of each of those funds and create a five-year forecast for each ISF. Set rates to departments based on a cost allocation study and

funding requirements for each ISF. Shift any excess balances into unrestricted fund balance to build the General Fund reserve.

RESULT: The City has not implemented this recommendation.

Recommendation 4: Determine the City Council's interest in asking the voters to approve new or increased taxes. Once that is ascertained, develop an action plan and schedule to seek voter approval of new revenues.

Utility User Tax Increase at 1%=	**$357,000**
Utility User Tax Increase at 2%=	**$714,000**
Sales Tax Increase of 1% =	**$1,200,000**
911 Communication Fee=	**$1,000,000**
Transient Occupancy Tax=	**$75,000**

RESULT: The City initiated two separate tax increase measures, with both failing to reach the required percentage of voters needed to approve the measures.

Recommendation 5: Engage a private firm to perform an audit of the property tax assessments to ensure data is current and up to date.

RESULT: The City has engaged HdL to audit property tax assessments and reconcile assessments.

Recommendation 6: Evaluate all franchise agreements for cost cutting and/or revenue generating opportunities.

RESULT: City staff has indicated to us they have evaluated all the franchise agreements for cost cutting and/or revenue generating opportunities.

Recommendation 7: Analyze the amount of additional revenue that would be received by the City if a change in the utility franchise fee allocation were implemented. Advocate for a change in legislation to correct the law.

RESULT: The City has not implemented this recommendation.

Recommendation 8: Implement a paramedic subscription program to recover costs associated with Contract Fire Service. Anticipated Revenue Increase: $240,000.

RESULT: Staff has indicated that this recommendation was reviewed and it was decided not to implement.

Recommendation 9: Develop a marketing program for paramedic subscriptions with a goal of market penetration to at least 50% of households. Develop marketing efforts to target those most likely to subscribe and plan a campaign that will be ongoing.

RESULT: The City has not implemented this recommendation.

Recommendation 10: Determine the fee level required to recover all City costs associated with false alarm response and increase fees accordingly. Anticipated Revenue Increase: TBD.

RESULT: Staff has worked with a consultant to update and increase cost recovery for the City and the Revised Fee Schedule was just approved by the City Council earlier this year.

Recommendation 11: Develop a comprehensive asset management program, identify market rental rates and subsidies, and sell unneeded and under-performing properties. Conduct an analysis of all property assets as part of the asset management program. Anticipated Revenue: TBD

RESULT: Most surplus real property assets are owned by the Successor Agency. The Successor Agency recently completed it Long Range Property Management Plan and waits approved from the Department of Finance. The next step is for the City and Successor Agency to implement the Plan.

Recommendation 12: Implement a 10 to 15 step range to spread out merit (performance) increases over six to nine years rather than the current three and a half to four.

RESULT: The City has implemented this recommendation.

Recommendation 13: Initiate discussions with Cal Fire and other cities in the area about a regionalized approach through the establishments of a Fire District. If successful, this could create economies of scale by eliminating redundant programs and costs.

RESULT: Staff and the City Manager are currently researching this recommendation.

Recommendation 14: Contract with the City of Palm Springs or Indio for all animal control services. Develop a detailed implementation plan.

RESULT: This recommendation has not been implemented.

Recommendation 15: Utilize retired police officers as trainers and reallocate full-time sworn personnel from this operation.

RESULT: City staff has indicated that the City uses 960 employees whenever possible, and thus has implemented this recommendation.

Recommendation 16: Merge the Planning, Building and Engineering with Community Development.

RESULT: The City has implemented this recommendation.

Recommendation 17: Create an internal and external communications and engagement plan. Temporarily reassign positions within the City to provide analytical support for implementing a budget stabilization plan and a communications plan.

RESULT: The City has not implemented this recommendation. City staff has asked for further clarification on this recommendation.

As a result, nine recommendations were either partially implemented or implemented and eight were not implemented or could not be implemented for a variety of reasons including voter disapproval of certain tax increases. The implementation of these recommendations, and other Council approved actions has kept total General Fund expenses flat. However, because the recommended revenue measures requiring voter approval were not approved, General Fund revenues have decreased by $700,000 between the FY 2012-13 and FY 2014-15. In sum, declining revenues have continued to bring pressure on the annual budgets.

As mentioned in our report dated February 12, 2012, it is extremely critical that the City act decisively to implement cost recovery and cost containment strategies. Because of recent reductions in operational expenses approved by the Council, the City will end the FY 2014-15 budget year with a positive General Fund balance of approximately $2.5M. To ensure that actions are meaningful and will make an ongoing impact to the future financial health of the City, the Strengths, Weaknesses, Opportunities, and Threats (S.W.O.T.) analysis that was completed in 2012 was revised for this report.

Using the general goals that were agreed upon and established in 2012 and understanding the challenges facing the City in 2015 and beyond, an updated S.W.O.T. analysis focused on high level elements:

Strengths:

- Based on actual year–to-date numbers and forecasts, combined General Fund total revenues will exceed expenses leading to a fund balance of approx. $2.5M. As with our

2012 recommendation, having a positive fund balance provides the City Council and staff time to prepare longer term strategies for implementation in FY 2015-16 and 2016-17.

- Current cuts will continue in the next budget year to keep in an attempt to keep the City's fund balance positive.
- City Council shows willingness to develop and implement policies and procedures that will help guide the City to fiscal recovery.
- A new management team brings new ideas and fresh approaches to deal with the City's current economic situation.
- The City has the potential for good economic development growth with available land, basic infrastructure and utilities in place, a workforce in place that covers the entire Coachella Valley and having a strategic location within the Coachella Valley
- Understanding that basic services need to be upgraded with several future service contract initiatives being addressed.
- The understanding that voter education efforts need to be undertaken so that the public can make informed decisions when asked to vote on tax measures.
- Decreases in insurance and retirement costs
- Understanding the need to begin retain and attract experienced staff and begin rebuilding staff moral
- Keeping positive about the future, yet having the discipline to make decisions that will not be popular, but will help the City in the mid and long run.

Weaknesses:

- Revenues will remain relatively flat over the next two fiscal years, while expenses will rise due to inflationary pressures.
- While personnel expenses have been significantly cut, staff departures have hurt continuity and institutional knowledge and recruitment efforts are hampered by the City's inability to compete with other local governments.
- Lack of specific policies and procedures to drive economic and fiscal actions
- Lack of a Citywide economic development strategic plan to include current goals and objectives, specific task identifiers, and opportunities within all strategically important areas of the City
- A high ratio of public safety costs to overall General Fund revenues
- Past usage of reserves and one-time monies to balance future budgets
- Certain public facilities that drain the City General Fund without specific plans to address the issues
- A significant erosion of city provided direct public services

- Sunset of two voter approved tax measures in FY 2019-2021 with disastrous results if not renewed or replaced
- Anticipated reduction in General Fund cash balances and no reserves.
- Lack of staff and resources to pursue opportunities
- Lack of utilities at vacant parcels thus adding a huge cost to development

Opportunities:

- Contracting out City services, including analyzing possible Public Safety Services
- Economic Development Strategic Plan Revisions
- Revenue enhancement and optimization
- Development and implementation of fiscal policies and procedures
- Use of financial models and other tools to keep the City Council and the community informed of the City's financial condition
- Working with other local governmental agencies to cost share and partner with.
- Budget process prioritization efforts
- Use of technology to lesson labor needs and enhance City services
- Bringing community stakeholders together in an organized process to help with budget priorities and revenue generation opportunities
- Availability of vacant land for economic development activities

Threats:

- Anticipated increases in police service costs
- Anticipated increases in public facility maintenance costs due to maintenance deferrals over the last several years
- Limited staffing to support basic services and economic development needs
- Allocation of resources not directly related to City basic services
- Expiring voter approved parcel and UTT revenues
- Unconvinced voters when requested to vote on parcel tax or fee increases
- Continued high unemployment and low median household income levels
- Undisciplined spending actions
- Past usage of fund balances to balance budgets leaving most fund balances at dangerously low levels
- Continued taking of local revenues by the State
- Increase levels of regulations & reporting requirements by the State of California

The updated S.W.O.T. analysis produced the following findings:

1. The City will need to seek to protect and expand its tax base by continuing to encourage a healthy underlying local economy. The City will need to revise its Five-Year Economic Development Strategic Plan and capitalize on its resources such as its flexibility, its employment availability and, its amount of vacant parcels to attract and retain small manufacturers, industrial developments, and regional retail centers. Non-minimum wage job creation should be a key in the revised plan.
2. The City must establish and maintain appropriate financial policies including cash reserves and cash reserve policies.
3. City revenue performance should be reviewed no less than quarterly (at least for the next 6-8 quarters) by the City Council and appropriate budget adjustments will need to be made in advance of the end of a budget year if revenue performance is not meeting projections. Use of a financial planning model is required.
4. The City should work to strengthen cost recovery and revenue collection practices and procedures.
5. The City Council needs to establish its "legally required services", and its "base services" and annually prioritize its budgeted programs through priority setting methods and tools.
6. The City needs to focus on longer range economic forecasting and establishing two or three-year strategic goals for the City Council to use and City staff to follow.
7. The City should review and revise all agreements and contracts it has with outside entities to see if these contracts and agreements serve the needs of the City and if there is a need to re-negotiate them in light of the City's current economic situation.
8. The City should aggressively contract out services when service delivery improvements can be identified and where clear, cost-effective alternatives exist.
9. The City should establish appropriate cost-recovery targets for its fee structures and will annually adjust its fee structures as part of the budget approval process to ensure that the fees continue to meet cost recovery targets.
10. The City should explore the use of a priority based two year budget system to help categorize and prioritize expenses necessary to produce a balanced budget for the next several years, including developing a citizen participation budget process to make suggestions to the City Council and staff on budget priorities.
11. The City Council should adopt a disciplined approach to financial decision-making and create rules and policies to ensure both short-term and long-term goals are not compromised in the decision making process.
12. The City is a service provider and employer. In order to provide a high level of service, the City must acknowledge the importance of providing a competitive wage to its staff.

From these S.W.O.T. findings, a number of elements emerge we believe the City needs to address and implement. These elements include short-term, mid-term and long-term goals and actions.

Appendix B: Summary of Cash Balances

City of Desert Hot Springs
Five Year Annual Projections
Consolidated Cash and Fund Balances
As of 05/11/2015

	FYE 6/30/2015	FYE 6/30/2016	FYE 6/30/2017	FYE 6/30/2018	FYE 6/30/2019	FYE 6/30/2020
REVENUES						
Property Tax	3,022,853	3,034,994	3,065,344	3,111,325	3,157,994	3,205,364
Sales Tax	3,087,612	3,118,846	3,150,034	3,197,285	3,245,244	3,293,923
Franchise Fees	1,288,467	1,175,640	1,187,396	1,205,207	1,223,285	1,241,635
Transient occupancy tax	1,386,033	1,285,200	1,298,052	1,317,523	1,337,286	1,357,345
Utility users tax	1,899,909	1,854,101	1,872,642	1,900,732	1,929,243	1,958,181
Business registration	184,192	182,305	184,128	186,890	189,693	192,539
Fee & Permits	691,780	665,186	671,838	681,915	692,144	702,526
Fines, Enforcement, Restitution	134,433	398,430	402,414	408,451	414,577	420,796
Use of Money and Property	18,390	8,686	10,773	10,934	11,098	11,265
Intergovernmental (Grants, Other Govts)	201,597	189,000	190,890	193,753	196,660	199,610
Miscellaneous	558,372	501,548	367,680	373,195	378,793	384,475
Transfers In	200,030	202,280	204,303	207,368	210,478	213,636
Total Revenues	12,673,665	12,616,217	12,605,495	12,794,577	12,986,496	13,181,294
EXPENSES						
Salaries & Benefits	3,834,392	4,725,273	4,816,252	4,912,577	5,010,829	5,111,045
PERS Retirement	547,041	542,005	559,175	570,358	581,766	593,401
Workers Comp	336,242	396,542	404,292	412,378	420,625	429,038
Taxes	281,847	294,716	300,610	306,623	312,755	319,010
Subtotal Salaries	4,999,521	5,958,536	6,080,329	6,201,936	6,325,974	6,452,494
Office and Adminstration	860,101	874,191	882,933	891,762	900,680	909,687
Operating Expenses	314,056	306,960	310,030	313,130	316,261	319,424
General Administrative Costs	365,698	362,870	366,499	370,164	373,865	377,604
Contractual Services	5,778,233	5,664,964	5,721,614	5,778,830	5,836,618	5,994,984
Interest Expense	-	-	-	-	-	-
Program Expenses	86,191	336	339	343	346	350
Operating Capital	-	-	-	-	-	-
Other Expenses	12,624	12,000	12,120	12,241	12,364	12,487
Transfers-Out	176,497	176,365	178,129	179,910	181,709	183,526
Subtotal O&M,	7,593,399	7,397,686	7,471,663	7,546,379	7,621,843	7,798,062
Total Expendit	12,592,920	13,356,222	13,551,992	13,748,315	13,947,818	14,250,556
Net Cash provided/(used) by Operations	80,744	(740,006)	(946,497)	(953,738)	(961,322)	(1,069,262)

	FYE 6/30/2015	FYE 6/30/2016	FYE 6/30/2017	FYE 6/30/2018	FYE 6/30/2019
Cash Balance					
Net Cash Excess/(Requirement)	80,744	(740,006)	(946,497)	(953,738)	(961,322)
General Fund - Beginning Cash	2,458,525	2,539,269	1,799,264	852,767	(100,971)
General Fund - Ending Cash	2,539,269	1,799,264	852,767	(100,971)	(1,062,293)
Fund Balance					
Net Revenues Over (Under) Expenses	80,744	(740,006)	(946,497)	(953,738)	(961,322)
General Fund - Beginning Balance	1,647,744	1,728,488	988,483	41,986	(911,752)
General Fund - Ending Balance	1,728,488	988,483	41,986	(911,752)	(1,873,074)